

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:LM:RFP:JAX:POSTF-123304-02  
RWDillard

date: May 30, 2002

to: Internal Revenue Service, Examination Division (LMSB)  
Attn: RA Pat Schorr

from: Associate Area Counsel  
(Retailers, Food, Pharmaceuticals & Health Care)

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subject: [REDACTED] Inc. & Subsidiaries  
Advisory Opinion

Issue

Whether the taxpayer can start amortizing an I.R.C. § 197 intangible of \$ [REDACTED] on its consolidated income tax return in [REDACTED].

Conclusion

No--the amortization cannot begin until [REDACTED].

Facts

[REDACTED] Inc. (" [REDACTED] ") is an independent licensee of the [REDACTED]. [REDACTED] is a [REDACTED] company. [REDACTED] is also a parent company and owns various subsidiaries. [REDACTED] files a consolidated tax return.

On [REDACTED], [REDACTED] Inc. (" [REDACTED] "), a licensed [REDACTED] in the State of [REDACTED] and a wholly-owned subsidiary of [REDACTED], purchased all of the outstanding stock of [REDACTED] Inc. (" [REDACTED] "), a licensed [REDACTED] in the State of [REDACTED]. [REDACTED] purchased the stock from [REDACTED] Inc. (" [REDACTED] "), the parent of [REDACTED], for \$ [REDACTED]. Concurrent with the transaction, the name of [REDACTED] was changed to [REDACTED] Inc. (" [REDACTED] "), a wholly-owned subsidiary of [REDACTED]. [REDACTED] and [REDACTED] are members of [REDACTED]'s consolidated group.

At the time of closing on [REDACTED], [REDACTED] had no employees. [REDACTED] agreed to "lease" its employees to [REDACTED] to service [REDACTED] (f.k.a. [REDACTED]) members during [REDACTED]. Although the

closing occurred on [REDACTED], [REDACTED] was responsible for all claims for covered services rendered to members prior to [REDACTED]. On [REDACTED], [REDACTED] took over the management of [REDACTED] (f.k.a. [REDACTED]).

[REDACTED] and [REDACTED] made a timely, joint election under I.R.C. § 338(h)(10) to treat the stock purchase as an asset purchase. Of the \$[REDACTED] purchase price, \$[REDACTED] was allocated to an I.R.C. § 197(f)(5) intangible. On the consolidated [REDACTED] tax return, [REDACTED] amortized \$[REDACTED] of I.R.C. § 197 intangibles<sup>1</sup>.

### Discussion

I.R.C. § 197 allows an amortization deduction for the capitalized costs of acquiring intangibles that are held by a taxpayer in connection with the conduct of a trade or business. I.R.C. § 197(c); Treas. Reg. § 1.197-2(a)(1). The amount of the deduction is determined by amortizing the adjusted basis of the acquired intangible over a 15-year period. I.R.C. § 197(a); Treas. Regs. § 1.197-2(a)(1).

The 15-year period begins on the later of (1) the first day of the month in which the property is acquired or (2) in the case of property held in connection with the conduct of a trade or business, the first day of the month in which the conduct of the trade or business begins. Treas. Reg. § 1.197-2(f)(1)(i)(A). I.R.C. § 197 only applies to direct acquisitions of § 197 intangibles, i.e. asset acquisitions, and not indirect acquisitions of intangibles through an acquisition of stock<sup>2</sup>. However, where the buyer and seller join in an election under I.R.C. § 338(h)(10) and the stock purchase is recharacterized as an asset purchase, I.R.C. § 197 will apply to the indirectly acquired intangibles. Treas. Reg. § 1.197-2(e)(5).

Pursuant to I.R.C. § 338, a corporation that acquires stock of another corporation can elect to treat the stock purchase as an asset acquisition. I.R.C. § 338(a). Where the purchasing corporation makes the election (or where the purchasing

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<sup>1</sup> The I.R.C. § 197 intangible reported on the return totaled \$[REDACTED]. The amount consisted of the \$[REDACTED] allocated to I.R.C. § 197(f)(5) and \$[REDACTED] of acquisition expenses. The amount amortized was for the [REDACTED] of [REDACTED] ((\$[REDACTED] / [REDACTED] years) X [REDACTED]). The correctness of the allocation to I.R.C. § 197 intangibles is not at issue.

<sup>2</sup> Section 197 does not apply to a stock acquisition because stock is specifically excluded from the definition of an I.R.C. § 197 intangible. I.R.C. § 197(e)(1)(A).

corporation and the seller make a joint election under I.R.C. § 338(h)(10)), the target corporation is treated as if it (the "old target") sold all of its assets at the close of the acquisition date of the target's stock. I.R.C. § 338(a)(1). The acquired corporation (the "new target") is then treated as a new corporation that purchased all of the assets on the day **after** the acquisition date. I.R.C. § 338(a)(2).

In this case, the new target ( ) is deemed to have purchased the assets from the old target ( ) on the day **after** the acquisition date. See I.R.C. § 338(a)(2). The day after the acquisition date is . As a result, the 15-year amortization period under I.R.C. § 197 begins on , the first day of the month in which property was acquired. See Treas. Reg. § 1.197-2(f)(1)(i)(A). Thus, is not entitled to start amortizing the I.R.C. 197 intangible in .

The taxpayer, without pointing to a specific code provision, claims that the assumption reinsurance rules of Subchapter L (I.R.C. §§ 801 - 818) override the Subchapter C rules (I.R.C. §§ 301 - 386) and, as a result, the amortization should start in . A Subchapter L provision, however, only supersedes a Subchapter C provision if there is a direct conflict between the two. See UNUM Corp. v. United States, 130 F.3d 501 (1st Cir. 1997). In this case, there is no conflict because Subchapter L does not address when the new target is deemed to purchase old target's assets (as addressed by I.R.C. § 338(a)(2)) or when the amortization period begins (as addressed by Treas. Reg. § 1.197-2(f)(1)(i)(A)).

The taxpayer also claims that for book/regulatory purposes the assets were owned on [REDACTED] and, as a result, the amortization should begin in [REDACTED]. However, book/regulatory accounting are irrelevant to how this fictional asset purchase must be treated under I.R.C. §§ 197 and 338. It is well recognized that tax accounting requirements may differ from financial/regulatory accounting standards and that financial/regulatory accounting standards are not controlling for tax purposes. See Thor Power Tool Co. v. Commissioner, 439 U.S. 522, 542-543 (1979); Highland Farms, Inc. & Subsidiary v. Commissioner, 106 T.C. 237, 250-51 (1996).

If you have any questions, please contact the undersigned at (904) 665-1987. We are returning your files.

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By: \_\_\_\_\_  
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Attachments: Your files.